



Department of the Treasury  
Internal Revenue Service  
P.O. Box 2508  
Cincinnati, OH 45201

Release Number: **201515037**  
Release Date: 4/10/2015  
UIL Code: 501.32-00

Date: January 13, 2015

Employer ID number:

Contact person/ID number:

Contact telephone number:

Form you must file:

Tax years:

Dear :

This letter is our final determination that you don't qualify for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code (the Code). Recently, we sent you a proposed adverse determination in response to your application. The proposed adverse determination explained the facts, law, and basis for our conclusion, and it gave you 30 days to file a protest. Because we didn't receive a protest within the required 30 days, the proposed determination is now final.

Because you don't qualify as a tax-exempt organization under Section 501(c)(3) of the Code, donors can't deduct contributions to you under Section 170 of the Code. You must file federal income tax returns for the tax years listed at the top of this letter using the required form (also listed at the top of this letter) within 30 days of this letter unless you request an extension of time to file.

We'll make this final adverse determination letter and the proposed adverse determination letter available for public inspection (as required under Section 6110 of the Code) after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in the Notice 437 on how to notify us. If you agree with our deletions, you don't need to take any further action.

We'll also notify the appropriate state officials of our determination by sending them a copy of this final letter and the proposed determination letter (under Section 6104(c) of the Code). You should contact your state officials if you have questions about how this determination will affect your state responsibilities and requirements.

If you have questions about this letter, you can contact the person listed at the top of this letter. If you have questions about your federal income tax status and responsibilities, call our customer service number at 1-800-829-1040 (TTY 1-800-829-4933 for deaf or hard of hearing) or customer service for businesses at 1-800-829-4933.

Sincerely,

Director, Exempt Organizations

Enclosures:

Notice 437

Redacted Letter 4036, *Proposed Adverse Determination Under IRC Section 501(c)(3)*

Redacted Letter 4038, *Final Adverse Determination Under IRC Section 501(c)(3) - No Protest*



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: November 12, 2014

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

B = Board Member  
C = Board Member  
O = State  
Q = Date  
S = Program

UIL:

501.32-00  
501.32-01  
501.33-00

d=Number  
e=Number  
f dollars=Amount  
g dollars=Amount  
h=Number  
j=Number  
k=Number  
m=Number  
n=Number  
p=Number

Dear :

We considered your application for recognition of exemption from federal income tax under Section 501(a) of the Internal Revenue Code (the Code). Based on the information provided, we determined that you don't qualify for exemption under Section 501(c)(3) of the Code. This letter explains the basis for our conclusion. Please keep it for your records.

Letter 4036 (Rev. 7-2014)  
Catalog Number 47630W

Issues

Do you qualify for exemption under section 501(c)(3) of the Code? No, for the reasons stated below.

Facts

You previously operated as a sole proprietorship; B and C who are husband and wife were your owners. Your primary purpose was to provide a historical portrayal that taught history, humanity, leadership and the power of one; you accomplished this by providing an educational program, S, in schools, libraries and theaters for a fee. B and C conducted this program and each received e% of the gross proceeds. You wanted to pursue funding through grants and donations so you could expand your programs. B incorporated you as a non-profit corporation under the state law of O on Q to conduct the same programs as the sole proprietorship as shown by your Certificate of Incorporation. You did not submit a complete copy of your Articles of Incorporation.

You provided the following information about your activities:

- You provide programs in schools, churches, community centers, medical facilities, workshops, health fairs, and at conventions.
- You operate a publishing company to market books and develop other products around the books.
- You serve school aged children, college students, families, and community groups that strive to teach humanitarian values that lead to developing great leaders.

Your board consists of five individuals, including B, C, another related individual, and two others.

Your compensation arrangements with board members are:

- You keep h% of the gross funds collected from S for support; j% of the net funds are then divided e% between your two board members and founders, B and C, as compensation for their services.
- B provides independent programs such as workshops, key note speaking and other educational programs. You retain h% of the gross funds for overhead costs and B receives the entire balance after the h% is deducted.
- You sell books and programs developed by B who owns the rights. B is paid j% of the net proceeds for the sale of these items after you receive h%.

Your marketing plan shows your goals are:

- To serve k students in at least m schools in the current year and expand n% for the next few years.
- To include book sales at each event; you plan for sales of about d books in the current year at f dollars each for a profit of g dollars. Your goal is to increase books sales by p% in the next year. You will offer your books and other materials developed by B at all of your events.
- To hold a workshop with a keynote presentation and a book project. This workshop is targeted to boys and girls clubs, scouts, and technical schools. The purpose is to instill hope and motivation. Donations will be requested from the groups served.
- To offer a free annual full day conference to the community providing education on healthy lifestyles that improves or maintains good health. You anticipate community sponsors and the selling of retail vendor space to pay for the conference.

Your office location remains the same after your conversion from sole proprietorship to a non-profit corporation, which is the home of B and C. In addition, all existing equipment and supplies are being transferred; you stated there was no "need of a formal agreement or funds transfer" because there are no obligations being passed on.

Your primary source of financial support is receipts from your educational programs, primarily S. Your secondary source of financial support is receipts from books and other items developed by B.

Expenses are for fundraising, other salaries and wages, interest, occupancy, depreciation and depletion, professional fees and other expenses such as program services.

## Law

Section 501(c)(3) of the Internal Revenue Code of 1986 (the "Code") provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable and educational purposes, no part of the net earnings which inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Regulations provides that the terms "private shareholder or individual" in Section 501 refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(a)(1) of the Regulations states that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational

test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) of the Regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization:

- (a) Limit the purposes of such organization to one or more exempt purposes; and
- (b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities that in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(b)(4) of the Income Tax Regulations provides that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose, either by an express provision in its governing instrument or by operation of law.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization operates exclusively for exempt purposes only if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3) of the Code. An organization must not engage in substantial activities that fail to further an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the Income Tax Regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals as defined in Section 1.501(a)-1(c).

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides that an exempt organization must serve a public rather than a private interest. The organization must demonstrate that it is not organized or operated to benefit private interests such as "designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests." Thus, if an organization is operated to benefit private interests rather than for public purposes, or is operated so that there is prohibited inurement of earnings to the benefit of private shareholders or individuals, it may not retain its exempt status.

Revenue Ruling 69-383, 1969-2 CB 113 describes a hospital which entered into an agreement with a hospital-based radiologist to compensate him on the basis of a fixed percentage of the departmental income. The radiologist did not control the hospital and the agreement was negotiated at arm's length. The amount the radiologist received was reasonable in terms of the responsibilities and activities that he assumed under the contract. For these reasons, it was held that the arrangement entered into between the hospital and the radiologist did not constitute inurement of net earnings to a private

individual within the meaning of section 1.501(c)(3)-1(c)(2) of the Regulations and the hospital retained its exempt status.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption. Regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In Harding Hospital, Inc. v. United States, 505 F.2d 1068 (6th Cir. 1974), the court held that an organization seeking a ruling as to recognition of its tax-exempt status has the burden of proving that it satisfies the requirements of the particular exemption statute.

In Basic Bible Church v. Commissioner, 74 T.C. 846 (1980), the Sixth Circuit court found that although the organization did serve religious and charitable purposes, it existed to serve the private benefit of its founders, and thus failed the operational test of section 501(c)(3). Control over financial affairs by the founder created an opportunity for abuse and thus the need to be open and candid, which the applicant failed to do.

In KJ's Fund Raisers v. Commissioner, T.C. Memo 1997-424 (1997), aff'd, 166 F.3d 1200 (2d Cir. 1998), the Tax Court held, and the Second Circuit affirmed, that an organization formed to raise funds for distribution to charitable causes did not qualify for exemption under section 501(c)(3) because its activities resulted in a substantial private benefit to its founders.

## **APPLICATION OF LAW**

You are not as described in section 501(c)(3) of the Code because you are not exclusively organized and operated for charitable or educational purposes.

You are not as described in Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations because you fail both the organizational and operational tests.

You do not meet the requirements in Section 1.501(c)(3)-1(b)(1)(i) and Section 1.501(c)(3)-1(b)(4) of the Income Tax Regulations. You did not provide a copy of your organizing document showing that your purpose and dissolution clause meet the requirements in Section 501(c)(3) of the Code; therefore, you fail the organizational test.

You do not meet the provisions of Section 1.501(c)(3)-1(c)(1) of the Regulations because more than an insubstantial part of your activities is not in furtherance of an exempt purpose; you took over B and C's sole proprietorship to obtain grant money to conduct the same activities as well as provide similar compensation to B and C after taking a small percentage for your operations. These facts show you are operating for substantial non-exempt private purposes.

You are not described in Section 1.501(c)(3)-1(c)(2) of the Regulations because you are not operated exclusively for exempt purposes since your net earnings inure to the benefit of private shareholders or individuals as defined in Section 1.501(a)-1(c). For example:

- You were formed by B and C to obtain grant money to provide the same services as the sole-proprietorship.
- Three of your five board members are related.
- Your compensation arrangements with B and C indicate inurement; for example they each receive e% of the proceeds from S after you receive h%; B receives j% of the proceeds from your other programs and items she developed that are sold at your programs.

You are not defined in Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations because you are operating to confer the advantages of tax-exempt status to B and C as shown by the fact that your tax exemption will enable them to apply for grants to expand their business. Moreover, the facts show a more than insubstantial part of your operations is the selling of intellectual property for the benefit of your creators. You further the personal interests of the board members, B and C.

You are not like the organization in Revenue Ruling 69-383, 1969-2 CB 113. Your compensation arrangements are with individuals who control you and were not negotiated at arm's length. These arrangements indicate inurement of net earnings to a private individual within the meaning of section 1.501(c)(3)-1(c)(2) of the Regulations and disqualify you from exemption.

You are like the organization in Better Business Bureau v. Commissioner. Although you may have some educational purposes, the presence of non-exempt private purposes precludes exemption under section 501(c)(3) of the Code.

Similar to the organization in Harding Hospital, Inc. v. United States, you have the burden of proving that you satisfy the requirements for tax exemption. You have failed to prove that you are not operating for the benefit of B and C.

Although some of your activities fulfill an educational purpose like Basic Bible Church v. Commissioner, supra, you have existed to serve the private benefit of your founders and thus fail the operational test of section 501(c)(3). Because your activities result in a substantial private benefit to your founders, you do not qualify for exemption as outlined in KJ's Fund Raisers v. Commissioner, supra.

## Conclusion

Based on the facts presented, you do not meet the organizational and operational tests in Section 1.501(c)(3)–1(a)(1) of the Income Tax Regulations; a substantial part of your activities inure to the benefit of B and C and do not further an exempt purpose. Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code.

### **If you don't agree**

You have a right to file a protest if you don't agree with our proposed adverse determination. To do so, you must send a statement to us within 30 days of the date of this letter. The statement must include:

- Your name, address, employer identification number (EIN), and a daytime phone number
- A copy of this letter highlighting the findings you disagree with
- An explanation of why you disagree, including any supporting documents
- The law or authority, if any, you are relying on
- The signature of an officer, director, trustee, or other official who is authorized to sign for the organization, or your authorized representative
- One of the following declarations:

**For an officer, director, trustee, or other official who is authorized to sign for the organization:**

Under penalties of perjury, I declare that I examined this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

**For authorized representatives:**

Under penalties of perjury, I declare that I prepared this protest statement, including accompanying documents, and to the best of my knowledge and belief, the statement contains all relevant facts and such facts are true, correct, and complete.

Your representative (attorney, certified public accountant, or other individual enrolled to practice before the IRS) must file a Form 2848, *Power of Attorney and Declaration of Representative*, with us if he or she hasn't already done so. You can find more

information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*.

We'll review your protest statement and decide if you provided a basis for us to reconsider our determination. If so, we'll continue to process your case considering the information you provided. If you haven't provided a basis for reconsideration, we'll forward your case to the Office of Appeals and notify you. You can find more information about the role of the Appeals Office in Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*.

If you don't file a protest within 30 days, you can't seek a declaratory judgment in court at a later date because the law requires that you use the IRS administrative process first (Section 7428(b)(2) of the Code).

**Where to send your protest**

Please send your protest statement, Form 2848, if needed, and any supporting documents to the applicable address:

**U.S. mail:**

Internal Revenue Service  
EO Determinations Quality Assurance  
Room 7-008  
P.O. Box 2508  
Cincinnati, OH 45201

**Street address for delivery service:**

Internal Revenue Service  
EO Determinations Quality Assurance  
550 Main Street, Room 7-008  
Cincinnati, OH 45202

You can also fax your statement and supporting documents to the fax number listed at the top of this letter. If you fax your statement, please contact the person listed at the top of this letter to confirm that he or she received it.

**If you agree**

If you agree with our proposed adverse determination, you don't need to do anything. If we don't hear from you within 30 days, we'll issue a final adverse determination letter. That letter will provide information on your income tax filing requirements.

You can find all forms and publications mentioned in this letter on our website at [www.irs.gov/formspubs](http://www.irs.gov/formspubs). If you have questions, you can contact the person listed at the top of this letter.

Sincerely,

Director, Exempt Organizations

Enclosure:  
Publication 892